

BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of the Application of	:	Docket No. 02-057-02
Questar Gas Company for	:	PRE-FILED DIRECT TESTIMONY OF
an Increase in	:	DONNA DERONNE
Rates and Charges	:	FOR THE COMMITTEE OF
	:	CONSUMER SERVICES

August 30, 2002

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INTRODUCTION

Q. WHAT IS YOUR NAME, OCCUPATION AND BUSINESS ADDRESS?

A. I am Donna DeRonne, a Certified Public Accountant licensed in the State of Michigan. I am a regulatory consultant in the firm Larkin & Associates, PLLC, with offices at 15728 Farmington Road, Livonia, Michigan 48154.

Q. PLEASE DESCRIBE THE FIRM LARKIN & ASSOCIATES.

A. Larkin & Associates, PLLC is a Certified Public Accounting and Regulatory Consulting Firm. The firm performs independent regulatory consulting primarily for public service/utility commission staffs and consumer interest groups (public counsels, public advocates, consumer counsels, attorney generals, etc.). Larkin & Associates, PLLC has extensive experience in the utility regulatory field as expert witnesses in over 400 regulatory proceedings, including numerous electric, gas, telephone and water utilities.

Q. HAVE YOU PREPARED AN EXHIBIT DESCRIBING YOUR QUALIFICATIONS AND EXPERIENCE?

A. Yes. I have attached Appendix I, which is a summary of my experience and qualifications.

Q. ON WHOSE BEHALF ARE YOU APPEARING?

A. Larkin & Associates, PLLC was retained by the Committee of Consumer Services (CCS or Committee) to analyze Questar Gas Company's (QGC) request for an increase in general rates, and to make recommendations based on that analysis to the Utah Public Service Commission (Commission).

I present the Committee's overall recommended revenue requirement calculations based on the analysis of Larkin & Associates, PLLC, and other consultants retained

by the Committee. These recommendations are based on a review of the test year ended December 31, 2001 and on the Company's projected future test period ending December 31, 2002.

Hugh Larkin, Jr., also of Larkin & Associates, PLLC, presents the Committee's overall policy recommendations with regards to the appropriate test period for use in setting rates. The Committee's primary position, as addressed by Mr. Larkin, is that the test year used in setting QGC's revenue requirement should be based on a 13-month average historical test year methodology, using the period ended December 31, 2001. Mr. Larkin also addresses revenues received from Geneva Steel and the Section 29 "tight sands" tax credit. The impact of Mr. Larkin's recommended adjustments is included in the overall summary exhibits attached to my testimony.

Q. WHAT EXHIBITS HAVE YOU INCLUDED WITH YOUR TESTIMONY?

A. The Committee's primary recommendation is that the 13-month average historical test year ended December 31, 2001 be used in calculating QGC's revenue requirement. Therefore, I have included exhibits calculating this primary recommendation. The exhibits addressing the historical test year only contain the prefix 3.1.1 through 3.1.6.

I am also providing exhibits calculating the revenue requirement for QGC utilizing a 13-month average projected test year ending December 31, 2002. While the Committee does not recommend the use of a projected test year, I am still providing calculations based on the projected test year for the Commission's information and use. The exhibits specifically addressing the projected test year are provided as CCS Exhibits 3.2.1 through 3.2.9.

Also, the majority of the specific adjustments I am recommending in this testimony impact both the historical test year and the projected test period. The calculations supporting the adjustments that impact both the historical test year (CCS Exhibit 3.1 schedules) and the projected test period (CCS Exhibit 3.2 schedules) are provided as CCS Exhibits 3.3.1 through 3.3.9.

Q. WHAT IS THE OVERALL REVENUE REQUIREMENT YOU ARE RECOMMENDING IN THIS CASE?

- A. A summary of the Committee's overall recommendation is shown on CCS Exhibit 3.1.1. The exhibit, based on the historical test year ended December 31, 2001, incorporates the rate base, revenue, and operating expense adjustments the Committee is recommending to the historical test year, which are shown on CCS Exhibits 3.1.2, 3.1.3 and 3.1.4, respectively. It also incorporates the income taxes calculated on CCS Exhibit 3.1.5, following the methodology used in previous Questar Gas rate cases. It also incorporates the overall rate of return recommended by CCS Witness David Parcell of 8.32%. As shown on CCS Exhibit 3.1.1, line 14, QGC's Utah DNG revenues should be reduced by \$14,203,000.

Committee Witness Michael McFadden recommends in his direct testimony that the expenses associated with the CO₂ plant be recovered through a separate tariff rider instead of through the DNG base rates. The impact of removing the CO₂ plant costs from the DNG revenue requirement has not been included in my revenue requirement calculations. If the Commission adopts the transfer of the CO₂ costs from DNG base rates to a separate tariff rider, the DNG revenue requirement and base rates must be adjusted accordingly.

Q. IF THE COMMISSION AGREES WITH THE COMPANY'S POSITION THAT A PROJECTED TEST YEAR SHOULD BE USED, WHAT WOULD BE THE

**COMMITTEE'S OVERALL REVENUE REQUIREMENT UNDER THE
PROJECTED TEST YEAR METHODOLOGY?**

- A. A summary of the Committee's revenue requirement calculations using an average projected test period ending December 31, 2002 is presented on CCS Exhibit 3.2.1. This exhibit incorporates the rate base, revenue, and operating expense adjustments the Committee is recommending to the projected test year, which are shown on CCS Exhibits 3.2.2, 3.2.3 and 3.2.4, respectively. It also incorporates the income taxes calculated on CCS Exhibit 3.2.5, along with the overall rate of return recommended by CCS Witness David Parcell of 8.32%. As shown on CCS Exhibit 3.2.1, line 14, even if a projected test year is used, QGC's Utah DNG revenues would still need to be reduced by \$11,899,000.

CONVERSION TO AVERAGE TEST YEAR

**Q. THE COMPANY'S FILING IS BASED ON YEAR-END RATE BASE LEVELS
AND ANNUALIZED REVENUES BASED ON YEAR-END CUSTOMER
LEVELS FOR BOTH 2001 AND 2002. WOULD YOU PLEASE DESCRIBE
HOW YOU CONVERTED THE 2001 TEST YEAR INFORMATION FROM A
YEAR-END METHODOLOGY TO AN AVERAGE METHODOLOGY?**

- A. The 2001 test year was the simpler of the two periods to convert to an average basis as the Company provided its adjusted Results of Operations for the period ended December 31, 2001 based on the traditional, 13-month average methodology. The main differences between the Results of Operations and the Company's filing for the year ended December 31, 2001 were for rate base and revenues. The Company's filing used the year-end rate base levels, along with an annualization in depreciation expense based on the year-end plant in service levels, and revenues annualized and weather normalized based on year-end customer levels. For the most part, the various adjustments made by the Company to

operating expenses remain unchanged, with a few minor exceptions (such as an adjustment to bad debt expense resulting from the annualization of revenues) and some corrections to the original filing made by the Company in the Results of Operations. I discuss the corrections made by QGC later in this testimony and further address some of the specific differences between the Results of Operations and the filing. Since the Committee's primary position is that an average rate base methodology continue to be used by the Commission, I used the Company's adjusted Results of Operations for the year ended December 31, 2001 as the starting point in my calculations for the 2001 test year in CCS Exhibits 3.1.1 through 3.1.5.

Q. WOULD YOU PLEASE NEXT DISCUSS HOW YOU CONVERTED THE YEAR-END PROJECTED 2002 TEST PERIOD TO AN AVERAGE TEST YEAR METHODOLOGY?

- A. Yes. My starting point was the Company's adjusted 2002 test year contained in its original filing. (Exhibit QGC 4.5 and Exhibit QGC 4.6) Since filing its testimony and exhibits in this case, the Company revised its 2002 capital budget to capture a substantial decrease in its projected capital expenditures and additions. The Company also increased the amount of projected plant retirements in 2002 by \$4 million. In response to DPU 10.3, the Company provided its revised projections and updated Exhibit QGC 4.6 (pages 2B and 4). The updated exhibits also contained some corrections to some of the items included in the original two exhibits. Consequently, the first two adjustments I made were to reflect the impact of these Company updates on the 2002 test year.

The necessary adjustments to QGC's original filing to include these significant updates are presented on CCS Exhibits 3.2.6 and 3.2.7. These two exhibits provide a side-by-side comparison of the Company's original adjustments for 2002

plant additions (along with the impact on related items such as depreciation, property taxes and accumulated depreciation) to the revised adjustments, along with the necessary adjustments to the original filing to reflect the changes. These changes were then incorporated in CCS Exhibit 3.2.2, page 2, columns A and C for items impacting rate base and on CCS Exhibit 3.2.4, page 2, columns A and C for items impacting operating expense.

Q. ONCE YOU REVISED THE STARTING POINT TO REFLECT THE COMPANY'S UPDATES TO ITS PROJECTED 2002 TEST YEAR, WHAT WAS YOUR NEXT STEP IN CONVERTING FROM THE 2002 YEAR-END TEST YEAR TO THE 2002 AVERAGE TEST YEAR?

- A. In Exhibit QGC 4.6, page 2A, the Company increased the revenues to be received from the GS-1 customer class by \$5,019,803. This is the difference between the Company's annualized and weather normalized revenues for this customer class based on 2001 year-end customer levels (after Utah Gas Services Company customers currently served under rate schedule GSE are rolled-in) and the projected annualized and weather normalized revenues for this same customer class based on projected 2002 year-end customer levels. According to Company witness Gary Robinson, (page 22 of his testimony), this adjustment reflects the annualization of 18,500 new customers that are projected to be added during 2002. The Company has not projected any growth in any of the remaining customer classes for 2002 in its filing, only for the GS-1 class. In fact, the Company has actually adjusted revenues received from other customer classes downward in its filing. The Company has reduced revenues for projected reduced consumption in gas by PacifiCorp for its gas-fired units, and it removed DNG revenues received during the 2001 test year from Geneva Steel.

Since the Committee is recommending an average rate base methodology be

used, I have removed 50% of the Company's adjustment on CCS Exhibit 3.2.3. This reduces projected 2002 revenues by \$2,510,000 (\$5,020,000 x 50%). This would reflect the impact of the projected 2002 growth in the GS-1 rate class customers as though it occurs evenly throughout 2002.

Q. PLEASE DISCUSS HOW YOU CONVERTED THE COMPANY'S PROJECTED YEAR-END RATE BASE, AFTER THE COMPANY'S UPDATES/REVISIONS, TO AN AVERAGE RATE BASE METHODOLOGY.

- A. The Company's adjustments to reflect a year-end rate base, along with a year-end level of associated costs such as depreciation expense and property taxes, were presented in two separate adjustments. The Company's Updated Exhibit QGC 4.6, page 2B presents the adjustments the Company made to go from the year end December 31, 2001 rate base to the year-end December 31, 2002 rate base associated with the addition of new customers. These adjustments consisted of: an increase in plant in service of \$54,638,200; a \$1,597,776 increase in depreciation expense and accumulated depreciation; a \$371,572 increase in property taxes; a \$45,178 increase in uncollectible expense; a \$458,208 increase in expenses for the addition of new employees; and a \$5,467,183 increase in accumulated deferred income taxes (which is an offset to rate base). In order to convert these amounts to an average rate base methodology, I assumed these additions would occur evenly throughout the year. On CCS Exhibit 3.2.2, page 2, column B, I removed 50% of the projected increases in plant in service and accumulated deferred income taxes. The adjustments for the items impacting operating expenses are presented on CCS Exhibit 3.2.4, page 2, column B. In column B, I removed 50% of the Company's projected increases in uncollectibles and property tax expense. I did not revise the depreciation expense or accumulated depreciation in these adjustments. These items are adjusted elsewhere, as discussed later in this testimony.

Q. PLEASE DISCUSS HOW YOU CONVERTED THE COMPANY'S PROJECTED ADDITIONS NOT RELATED TO NEW CUSTOMERS INTO AN AVERAGE METHODOLOGY.

- A. The Company presents its projected additional plant and related expenses for 2002 on Updated Exhibit QGC 4.6, page 4. This updated exhibit, along with the supporting workpapers and calculations, was provided as part of the response to DPU 10.3. In the Updated Exhibit QGC 4.6, page 4, QGC increased plant in service by \$9,542,604. However, according to a workpaper provided with the response, this \$9,542,604 increase consists of: (1) \$4,977,920 of projected 2002 capital expenditures; (2) \$24,736,823 for items that the Company is transferring from Account 106 - Completed Construction Not Classified to Account 101 - Plant in Service; (3) -\$1,172,139 for the projected change in Account 107 - Construction Work in Progress; and (4) -\$19,000,000 for projected plant retirements. The combination of these four items results in the projected increase in plant in service of \$9,542,604. Absent the transfer of assets from completed construction not classified to plant in service, the Company's adjustment would have resulted in a decrease to plant in service as the amount of projected retirements exceeds the projected additions not related to customer growth.

In order to convert the projected plant additions and plant retirements to an average test year basis instead of a year-end basis, I combined the components of the calculation pertaining to the capital budget additions, change in construction work in progress, and plant retirements. Combined, these items result in a reduction to rate base of \$15.19 million. Assuming that this net reduction (i.e., the increases in plant in service for additions and decreases for retirements) occurs evenly throughout the projected 2002 year, I increased plant in service by \$7,597,000 on CCS Exhibit 3.2.2, page 2, Column D. In the calculation, I did not include the increase in plant in service of \$24,736,823 for the transfer of assets from Account 106-completed

construction not classified to plant in service. The \$24,736,823 contained in completed construction not classified was actually in service at the beginning of the 2002 test year and, therefore, should remain at the 100% level.

Q. PLEASE CONTINUE WITH YOUR DISCUSSION.

- A. The remaining adjustments made by the Company on Updated Exhibit QGC 4.6, page 4, consisted of: a \$3,421,826 increase in depreciation expense; a \$64,895 increase in property taxes; a \$394,514 decrease in deferred investment tax credits, a \$30,866 increase in accumulated deferred taxes, and a \$24,872,293 increase in accumulated depreciation. The sharp increase in accumulated depreciation includes an additional full year's worth of depreciation on the plant balances as of December 31, 2001. I note that while the Company has substantially decreased the amount of projected other plant additions and has increased its projected plant retirements, the increase to depreciation expense in its update is \$460,959 higher than the amount contained in its original adjustment. Intuitively, it does not make sense that the amount of projected plant additions are decreasing and the amount of plant retirements are increasing in the update, and that these changes would result in an increase to depreciation expense.

In order to convert the Company's adjustments to an average test year methodology, I assumed these additions would occur evenly throughout the year. On CCS Exhibit 3.2.2, page 2, column D, I removed 50% of the projected increases in deferred investment tax credits and accumulated deferred income taxes. The adjustments for the items impacting operating expenses are presented on CCS Exhibit 3.2.4, page 2, column D. In column D, I removed 50% of the Company's projected increases in property tax expense.

Q. PLEASE EXPLAIN WHY YOU DID NOT REMOVE 50% OF THE COMPANY'S

**UPDATED ADJUSTMENTS TO ACCUMULATED DEPRECIATION AND
DEPRECIATION EXPENSE AS PART OF THE ADJUSTMENTS DESCRIBED
ABOVE?**

- A. It appears there are errors in, and problems with, the Company depreciation calculations used in determining the depreciation expense and accumulated depreciation adjustments in its updated Exhibits 4.6, pages 2B and 4. As previously mentioned, intuitively it does not make sense that the amount of plant being added has been lowered while the amount of associated depreciation expense is being increased. In its response to DPU 10.3, QGC provided the workpapers and calculations it used in calculating the depreciation expense adjustment, increasing depreciation expense by \$1,597,776 on Updated Exhibit QGC 4.6, page 2B and by \$3,421,826 on Updated Exhibit QGC 4.6, page 4. Based on the workpaper provided in Attachment 2 to the response, the Company calculated a full-year of depreciation expense for 2002 based on the projected end of year plant balances, totaling \$41,602,171. According to footnote 4 in Attachment 4 of the response, in calculating the adjustment of \$3,421,826, the Company started with the \$41,602,171 of total calculated depreciation expense, subtracted the new customer-related depreciation expense (amount included in its Updated Exhibit QGC 4.6, page 2B for new customers) and subtracted the 2001 depreciation expense of \$34,984,793. While the Company claims in the footnote that this results in an adjustment to depreciation expense of \$3,421,826, the actual calculation would result in a net adjustment of \$5,019,602 ($\$41,602,171 - \$1,597,776 - \$34,984,793$). Consequently, either the footnote explaining the calculation is incorrect, or the actual calculation is incorrect. At this point, I am assuming that the calculation is incorrect. However, even if the footnote is correct, the calculation would still be flawed.

- Q. PLEASE EXPLAIN.**

- A. In the attachment provided, the Company is essentially calculating the difference between its calculated depreciation expense based on the projected December 31, 2002 plant balances and the depreciation expense actually recorded on its books for the period ending December 31, 2001. The \$34,984,793 shown on the Company's workpaper as the year-end 2001 balance of depreciation expense ties in exactly to the amount actually recorded by the Company during the 2001 historical test year in Account 403 - Depreciation Expense. However, in its adjustments to the 2001 test year in Exhibits QGC 4.3 and 4.4, the Company increased the booked depreciation expense by \$2,576,982 to annualize depreciation based on 2001 end-of-year plant balances. This adjustment is shown on Exhibit QGC 4.4, page 24. Since the Company's calculations for its projected 2002 year-end test year begins with its adjusted annualized year-end 2001 test year, the adjustment made to 2001 booked depreciation expense in the Company's filing should also be considered in calculating the adjustment.

Q. ARE THERE ANY SIGNIFICANT DIFFERENCES BETWEEN HOW THE COMPANY CALCULATED DEPRECIATION EXPENSE IN ITS UPDATED EXHIBITS COMPARED TO THE AMOUNTS CONTAINED IN THE ORIGINAL FILING?

- A. Yes. Unfortunately, the substantial updates to the Company's 2002 test year resulting from its reductions to the 2002 construction budget were not provided until recently. In addition to the updates to reflect the reduction to the 2002 construction budget, it appears the Company also materially changed the methodology by which it calculated the annualized depreciation amounts. Since the updates were provided so late in the review process, I did not have adequate time to fully investigate the substantial changes to the depreciation annualization calculations, nor to investigate the apparent errors in the calculations.

Q. DO YOU HAVE AN ALTERNATIVE RECOMMENDATION FOR HOW THE PROJECTED 2002 DEPRECIATION EXPENSE AND ACCUMULATED DEPRECIATION BALANCES SHOULD BE DETERMINED?

- A. Yes. If a 2002 test year is used, I recommend a different methodology be employed for projecting depreciation expense. Ideally, the Company should provide the projected plant balances by subaccount. The actual depreciation rates should then be applied to each of the projected plant balances to coordinate the depreciation expense and accumulated depreciation request with the requested plant in service balances. The Company provided its current depreciation rates by subaccount in response to DPU 4.14. If the Commission elects to use a projected test year for setting new rates, I recommend that my proposed method be used for calculating depreciation expense.

Any adjustments or revisions ultimately adopted by the Commission could then flow through this same calculation. The depreciation rates would be applied to the Commission's approved plant in service balances, by subaccount. This is how projected depreciation expense is calculated in several other states in which I have participated in rate case proceedings. My recommended method results in the depreciation expense, and related increase in the accumulated depreciation balance, being directly coordinated (i.e., matched) with the allowed plant in service balances.

Q. HAVE YOU PREPARED AN EXHIBIT SHOWING WHAT ADJUSTED DEPRECIATION EXPENSE FOR THE 2001 TEST YEAR WOULD BE USING YOUR RECOMMENDED METHODOLOGY?

- A. Unfortunately, I did not have all of the information available to prepare an exhibit under this method. In response to DPU 4.14, the Company provided an attachment with its current depreciation rates. The Results of Operations provided by the

Company contains a breakdown of the plant in service balances, by account and by month, for 2001 in Exhibit 4 - Inputs. However, the amounts provided were not separated into the subaccount level needed to calculate the depreciation expense. For example, there are several subaccounts under account 325 - Land & Land Rights. Most of these subaccounts have a depreciation rate of 3%, while one of the accounts -- Acct. 325.81 for land -- has no depreciation applied at all. The Results of Operations only gives the total balances for Account 325, without further subaccount detail. Another example is for Account 391 - Office Furniture & Equipment. The Results of Operations only includes the total amount for this account without the subaccount breakdown. However, each of the subaccounts in Account 391 have different depreciation rates applied. Also, for some of the adjustments made by the Company to the actual December 31, 2001 balances to determine the adjusted projected December 31, 2002 balances, I do not have the subaccount detail.

Q. GIVEN THAT ALL OF THE NECESSARY INFORMATION HAS NOT BEEN PROVIDED, IS THERE AN ALTERNATIVE METHOD THAT CAN BE USED?

A. Yes. Instead of applying the depreciation rates to the projected plant in service on an account-by-account basis, the average effective depreciation rate for 2001 could be used. On CCS Exhibit 3.2.8, I calculated the average depreciation rate for 2001 by dividing the 2001 actual booked depreciation expense of \$34,985,000 (Account 403) by the 2001 average plant in service balance of \$1,059,694,000. This results in an average depreciation rate for QGC of 3.30%. If the Company does not provide the level of information necessary to determine the projected depreciation expense by subaccount, the Commission could apply the average depreciation rate of 3.30% to the amount of plant in service ultimately approved in this case, should a projected test year methodology be used.

Q. HAVE YOU CALCULATED AN ADJUSTMENT FOR THE PROJECTED 2002 TEST YEAR DEPRECIATION EXPENSE USING THIS METHOD?

- A. Yes. On CCS Exhibit 3.2.8, I calculate the Committee's recommended depreciation expense and accumulated depreciation under an average 2002 test year methodology. I first apply the calculated average depreciation rate of 3.30% to my recommended 2002 adjusted plant in service balance (average test year method), resulting in projected 2002 depreciation expense of \$37,799,000. This is approximately \$2.8 million higher than the actual depreciation expense recorded by the Company during 2001. I then subtract the amount included in the Company's filing for 2002 for depreciation expense, including the impacts of the Company's updates. As shown on line 10, depreciation expense should be reduced by \$4,671,000. This should result in an estimation of the actual depreciation expense that would be recorded during 2002, as opposed to an annualized year-end level. This \$4.671 million reduction is reflected in my summary schedules on CCS Exhibit 3.2.4, page 2, column E.

Q. WHAT IMPACT DOES YOUR RECOMMENDED METHOD AND ADJUSTMENT TO DEPRECIATION EXPENSE HAVE ON THE COMPANY'S PROPOSED ACCUMULATED DEPRECIATION BALANCE?

- A. My recommended accumulated depreciation balance is also calculated on CCS Exhibit 3.2.8, lines 11 through 19. I first started with the actual adjusted accumulated depreciation balance as of December 31, 2001 of \$475,474,000. This is the adjusted balance for that date included in the Company's filing and reflects the Company's Wexpro adjustment. I then increase the accumulated depreciation balance by \$18,899,000, which is 50% of my recommended 2002 depreciation expense. The 50% factor is applied as the Committee is recommending that the average test year methodology continue to be used. On line 13, I then reduce the accumulated depreciation balance by \$9.5 million, which is

50% of the Company's updated projected retirements (\$19M x 50%). This results in my recommended adjusted 2002 average test year accumulated depreciation balance of \$484,873,000. I then subtract from this figure the amount of accumulated depreciation included in the Company's filing, including the updates. This results in a \$17,070,000 reduction to accumulated depreciation.

Q. YOU INDICATED ABOVE THAT THE COMPANY HAS SIGNIFICANTLY REDUCED ITS PROJECTED CAPITAL EXPENDITURES SINCE FILING ITS TESTIMONY AND EXHIBITS IN THIS CASE. DO YOU HAVE ANY CONCERNS WITH THE COMPANY'S PROJECTED ADDITIONS TO PLANT IN SERVICE, AS REVISED?

A. Yes. In Response to DPU 15.1 and 15.1U (updated), the Company provided a comparison of the original capital budget (\$68,616,120), the current capital budget (\$59,616,120) and the actual capital expenditures through June 30, 2002 (\$24,232,201). Based on the information provided, as of the mid-point of 2002 (or 50% into the year), the Company has only spent 40.6% of the current capital budget amount. Based on the first six months of the year, the Company is already significantly below spending 50% of the capital budget incorporated in its updated exhibits. Consequently, if a 2002 test year is adopted by the Commission, even larger adjustments than those presented in the Company's updates may be appropriate. The Commission may want to consider applying a factor to the Company's updated projections based on the percentage that the Company is under with respect to its revised capital budget. The fact that the Company has only spent 40.6% of its current capital budget further demonstrates the problems with adopting a future projected test period. Forecasted information may change significantly, as has already been the case for QGC.

Another concern I have is the lack of detail provided by the Company in support or

its capital expenditure projections. DPU 1.17 asked the Company to provide the capital budget supporting the projected other plant additions. The capital budget provided by the Company consisted of a one page document listing total dollar amounts by plant category. DPU 1.10 asked QGC to provide a copy of the 2002 capital budget supporting the projected plant additions for new customers of \$54,638,000. The Company merely referred to its previous one page response. While the Company is asking the Commission for plant additions based on projected end of period (12/31/02) plant levels, it has provided little detail or support for the projections.

Corrections to the Company's Filing

Q. GIVEN THAT THE COMPANY'S UTAH RESULTS OF OPERATIONS FOR THE TWELVE-MONTHS ENDING DECEMBER 31, 2001 WAS FILED SUBSEQUENT TO THE FILING OF THE COMPANY'S TESTIMONY AND EXHIBITS IN THIS RATE CASE PROCEEDING, DID THE COMPANY IDENTIFY ANY ERRORS TO THE ORIGINAL FILING FOR WHICH IT CORRECTED IN THE RESULTS OF OPERATIONS?

A. Yes. On the cover page submitted with the Results of Operations (ROO), dated July 19, 2002, the Company indicated that four issues have been identified that require adjustments that were not included in its rate case exhibits and direct testimonies.

The four issues specifically identified in this cover letter are:

1. Tax rate change from 38.02491% to 38.0384%;
2. Sales of property;
3. Advertising expenses; and
4. Incentive compensation.

Q. HOW DO THESE CORRECTIONS IMPACT THE COMMITTEE'S REVENUE REQUIREMENT RECOMMENDATIONS?

- A. Based on an average historical test year ending December 31, 2001, utilizing the Results of Operations, each of these four Company proposed corrections would already be included in the Committee's revenue requirement calculations. However, these corrections need to be reflected in the average 2002 test year, where appropriate.

Q. DO YOUR IMPUTED TAX CALCULATIONS PRESENTED IN CCS EXHIBITS 3.1.5 AND 3.2.5 INCLUDE THE REVISED COMBINED TAX RATE?

- A. Yes, they do. I have incorporated the Company's revised combined state and federal income tax rate of 38.0384%.

Q. PLEASE DISCUSS THE COMPANY'S CORRECTION TO ADVERTISING EXPENSE.

- A. In response to Committee Data Request 1.3, the Company indicated that several of the advertising costs identified as informational that were included in the adjusted test year in the original filing were inadvertently included. The costs were associated with advertisements appearing in Wyoming that were expressly stated to have been paid for by shareholders. In the Results of Operations, the Company corrects this adjustment, which reduces expense by approximately \$131,000. I have reflected this correction in the 2002 projected test year (CCS Exhibit 3.2.4, page 2, Column G). As I previously stated, this correction is already effectively included in the 2001 test year.

Q. PLEASE ADDRESS THE CORRECTION FOR THE SALES OF PROPERTY.

- A. The Company has sold property over the last several years that has been included in Utah rate base. Several of these properties, although they have been sold, are still included in plant in service and plant held for future use on the Company's books. In the Results of Operations, the Company removed the amounts included in plant in service and accumulated depreciation, along with depreciation expense, for

these sold properties.

Q. DID YOU PREPARE A SCHEDULE TO REFLECT THE REMOVAL OF THE PROPERTIES FROM RATE BASE AND DEPRECIATION EXPENSE FOR THE AVERAGE 2002 TEST PERIOD?

A. Yes. The required adjustment, resulting in a \$3.886 million reduction to rate base and a \$149,044 reduction to depreciation expense, is calculated on CCS Exhibit 3.2.9. The amounts differ slightly from the amounts included in the Results of Operations because the balance of accumulated depreciation on these assets would have increased in 2002, resulting in a different reduction to plant in service. Additionally, the Cedar Creek Service Center was sold in February 2002. The sale of this property is also reflected in CCS Exhibit 3.2.9. The adjustment also differs from the 2001 test period because the Company already removed two properties in its projected 2002 test year.

Q. ARE THERE ANY ADDITIONAL DIFFERENCES BETWEEN THE ADJUSTMENT REFLECTED IN THE COMPANY'S RESULTS OF OPERATIONS AND THE ADJUSTMENT YOU ARE MAKING TO THE PROJECTED 2002 AVERAGE TEST YEAR?

A. Yes. According to the updated response to DPU 10.15 (dated August 14, 2002) the amounts provided in the original response, which also tie directly into the Results of Operations, were incorrect for both the Price property and the Cedar Creek Service Center. CCS Exhibit 3.2.9 reflects the corrected amounts for these two properties.

Q. DOES THIS CORRECTION PROVIDED BY THE COMPANY ALSO IMPACT THE AMOUNT OF THE ADJUSTMENT PRESENTED IN THE COMPANY'S RESULTS OF OPERATIONS?

A. For one of the properties, it does. The Cedar Creek Service Center was sold

during 2002, so the sale of this property is not (and should not be) reflected in the 2001 Results of Operations. However, the Price property sale, which occurred in March of 1999, is included. The revision needed to correct the Company's original adjustment for the Price property sale is reflected on CCS Exhibit 3.1.2, page 2, Column A and results in a \$204,000 rate base reduction in the 2001 test year.

Q. DO YOU HAVE ADDITIONAL CONCERNS REGARDING THE COMPANY'S SALE OF PROPERTIES?

A. Yes. This same issue was addressed in the Company's last rate case, Docket No. 99-057-20. That case utilized a historical test year ended December 31, 1999. In that case, QGC indicated that five properties that were sold during the period 1997 through 1999 remained on the Company's books. In that case, QGC agreed that those properties should be removed from rate base. Those five properties still remain on the Company's books. Additionally, in the results of operations for the 12 months ending December 31, 2001, under Exhibit 5.7, Workpaper A, the Company identified nine properties that had been sold prior to December 31, 2001 which were still included on the Company's books as of that date. Considering the Company's attention was drawn to this specific issue in the previous rate case, I am surprised that the sold properties have not been removed from its books. By leaving these properties on its books, the Company would continue to charge depreciation rates to those items resulting in additional depreciation expense being booked and additional accumulated depreciation. I recommend that the Company be ordered to remove these balances from its books as part of the final decision in this case. Such an order would hopefully prevent the same issue from once again appearing in a future proceeding.

Q. WOULD YOU PLEASE ADDRESS THE FINAL CORRECTION MADE BY THE COMPANY IN THE RESULTS OF OPERATIONS?

A. The final correction identified by the Company is a correction to its incentive

compensation adjustment. I recommend several other revisions to the Company's incentive compensation adjustment. I will address the Company's correction, along with my remaining recommended revisions to incentive compensation, later in this testimony.

RECOMMENDED RATE BASE ADJUSTMENTS

Contractor Retainage

Q. ARE THERE ANY ITEMS ON THE COMPANY'S BOOKS THAT SHOULD BE REFLECTED AS AN OFFSET TO RATE BASE WHICH THE COMPANY DID NOT INCLUDE IN ITS FILING OR IN ITS RESULTS OF OPERATIONS?

A. Yes. As of December 31, 2001, the Company had a deferred credit on its books in Account 253 of \$1,345,002 identified as retainage. In response to DPU 10.13, the Company indicated that this balance is for retainage on projects. The response also indicated: "When the Company hires contractors to construct pipelines or other facilities, we retain a portion of the payment to them in this account until they have fully performed on the contract." This contractor retainage would represent a cost free source of capital to the Company. As the retainage pertains to pipeline and other facility projects which are rate base items rather than expense items, the impact of this retainage would not flow through to the Company's lead lag study. Consequently, rate base should be offset for this cost free source of capital for the Company.

Q. WHAT AMOUNT SHOULD BE USED AS THE OFFSET TO RATE BASE FOR THE CONTRACTOR RETAINAGE?

A. Ideally, the 13-month average balance for the historical test year ended December 31, 2001 should be used. Because monthly balance information is not available, I recommend that the beginning and ending 2001 balance be used. These amounts are obtained from the Company's 2001 FERC Form 2, at page 269. The FERC

Form 2 identifies the beginning year balance as \$956,100 and the end of year balance as \$1,345,002. The average of these two amounts is \$1,151,000. I have reflected the \$1,151,000 reduction to rate base on CCS Exhibit 3.1.2, page 2, Column B for the 2001 test year and on CCS Exhibit 3.2.2, page 2, Column H for the 2002 test year.

Q. IS IT A NORMAL OPERATING PRACTICE FOR THE COMPANY TO HAVE A CONTRACTOR RETAINAGE ON ITS BOOKS?

- A. I believe so. For example, the Company's 2000 FERC Form 2 indicated that the Company had a beginning retainage balance as of January 1, 2000 of approximately \$1,000,000. Thus, the Company has relied on this practice for at least the last several years.

Banked Vacations - 2002

Q. ON CCS EXHIBIT 3.2.2, PAGE 2, THERE IS AN ADJUSTMENT TO THE 2002 TEST YEAR TO REDUCE RATE BASE BY \$54,000 IN COLUMN G TITLED "BANKED VACATIONS 13-MONTH AVERAGE." A SIMILAR ADJUSTMENT DOES NOT APPEAR IN YOUR SCHEDULE OF RATE BASE ADJUSTMENTS TO THE 2001 TEST YEAR. COULD YOU PLEASE EXPLAIN WHAT THIS ADJUSTMENT IS FOR AND WHY IT IS ONLY REFLECTED FOR THE 2002 TEST YEAR?

- A. In Exhibit QGC 4.4, page 6, the Company provided the monthly balances of banked vacations. The banked vacations result because the Company's employees are allowed to accrue up to one-year's worth of allowed vacation and carry it forward. This banked vacation represents a benefit earned by employees that has not yet been paid by the Company, resulting in a cost free source of capital to the Company. Company witness Gary Robinson's testimony, at page 12, indicates that the Order in Docket No. 93-057-01 included an adjustment to reduce rate base by

the average amount of this banked vacation balance. In the current filing, the Company made an adjustment to remove the year-end banked vacation balance of \$779,000. In the Company's Results of Operations for the period ending December 31, 2001, QGC made an adjustment to reduce rate base by banked vacations using a 13-month average balance. While I agree that it is appropriate to base the reduction to rate base on a 13-month average balance (as the Company has done in its Results of Operations) an adjustment is necessary to the projected 2002 test year because that balance would still be based on a year-end balance. Using the monthly balances provided by the Company in Exhibit QGC 4.4, page 6, the appropriate 13-month average balance to be deducted from rate base should be \$832,928. This amount is approximately \$54,000 less than the amount included by the Company as an offset in its filing. This \$54,000 reduction is reflected on CCS Exhibit 3.2.2, page 2, Column G.

Q. IF THE COMMISSION DETERMINES THAT A YEAR-END RATE BASE SHOULD BE USED, DOES THIS ADJUSTMENT STILL NEED TO BE MADE?

- A. Yes. The banked vacation balance fluctuates from month-to-month depending on how the employees accrue vacation time and when vacations are taken. Consequently, it would be more appropriate to base this balance on a 13-month average versus a year-end amount. This is true even when a year end rate base approach is used.

RECOMMENDED REVENUE ADJUSTMENTS

Utah Gas Company Customers

- Q. THE COMPANY FINALIZED ITS MERGER WITH UTAH GAS SERVICES COMPANY AND WYOMING INDUSTRIAL GAS COMPANY ON JULY 12, 2001. DOES THE COMPANY'S RESULTS OF OPERATIONS CONTAIN ANY ADJUSTMENTS TO REFLECT THE ANNUALIZATION OF THE IMPACT OF**

THIS MERGER?

- A. In Exhibit 5.25 of the Results of the Operations for the period ended December 31, 2001, the Company included an adjustment to annualize the impact on rate base resulting from the merger. In other words, the Company made adjustments to the 2001 results to reflect the consolidation with Utah Gas Service Company as if it were in effect for the entire year. The specific accounts adjusted by the Company were plant in service, accumulated depreciation, customer deposits, depreciation expense, amortization expense, and taxes other than income taxes. While the Company has included a full 12-month impact of the merger in determining rate base and depreciation and amortization expense, its Results of Operations does not include an adjustment to reflect the impact on revenues resulting from the addition of this customer base. The Results of Operations only includes the actual weather normalized revenues received from these new customers for the period subsequent to the merger (July 2001 through December 2001). It clearly is not appropriate to include the merger in rate base and in depreciation and amortization expense as if it were in effect for the entire year and not also reflect the impact on revenues resulting from that merger. This would clearly result in a mismatch between investment (rate base), costs and revenues.

Q. WHAT IS YOUR RECOMMENDATION?

- A. I recommend that the revenues received from this new customer base be annualized as though they were customers of the Company for the entire year. Because the Utah Gas Service Company customers were on different rate schedules prior to the merger than the Questar Gas existing customers, they have been served under rate schedules GSE and F1E from the time of the merger to date. I have calculated an adjustment to estimate the annualized impact of the provision of service to the Utah Gas Service Company customers on 2001 test year revenues on CCS Exhibit 3.1.6.

On Company Exhibit QGC 4.6, page 1, QGC provided the annualized and weather normalized revenues under rate class GSE, which would be for the previous Utah Gas Service Company customers, for the year ended December 31, 2001. As shown on CCS Exhibit 3.1.6, the annualized and weather normalized DNG revenues for this customer class, as calculated by the Company, are \$2,755,776. The Company's adjusted 2001 Results of Operations include \$1,261,443 in revenues for these same customers. As shown on CCS Exhibit 3.1.6, line 3, revenues should be increased by \$1,494,333 to reflect an annualized level of DNG revenues to be received from these additional customers. On lines 4 through 6 of CCS Exhibit 3.1.6, I also annualize the DNG revenues received from the previous Utah Gas Service Company customers under rate class F1E using the same methodology. This results in an increase in revenues for rate schedule F1E of \$28,907. Combining the annualized revenues of these two classes results in an increase in DNG revenues of \$1,523,240.

Q. WHAT ABOUT THE EXPENSES ASSOCIATED WITH SERVING THESE NEW CUSTOMERS?

A. As previously indicated, the Company has already reflected a year's worth of depreciation expense, amortization expense, and taxes other than income associated with the merger of the Utah Gas Service Company. Additionally, the Company's labor annualization adjustment in the Results of Operations is based on the Company's employee level at the end of 2001. Consequently, any increased labor cost associated with providing service to these new customers would already be reflected on an annualized basis in the Results of Operations.

Q. WOULD YOU PLEASE DISCUSS YOUR NEXT ADJUSTMENT ON CCS EXHIBIT 3.1.3 ENTITLED "ADJUSTMENT TO REFLECT SHIFT FROM PRIOR

UTAH GAS COMPANY RATE SCHEDULES TO CURRENT QGC RATE SCHEDULES”?

- A. My understanding is that the Commission’s final decision in the merger case requires that these prior Utah Gas Service Company customers be transferred over to QGC’s tariff schedules. On Exhibit QGC 4.6, page 1, the Company made an adjustment to reflect the impact of shifting these customers from the rate schedules they are currently served on (i.e., GSE and F1E) to QGC’s rate schedules. On Exhibit QGC 4.6, page 1, the Company calculated the impact as a reduction to Utah DNG revenues of \$392,278. Since this is a price change, I have similarly reflected the revenue reduction of \$392,000 on CCS Exhibit 3.1.3.

Contributions in Aid of Construction

Q. IN ITS FILING, QGC MAKES AN ADJUSTMENT TO THE 2002 TEST YEAR FOR CONTRIBUTIONS IN AID OF CONSTRUCTION. WOULD YOU PLEASE DISCUSS THIS ADJUSTMENT?

- A. Company witness Gary Robinson describes the Company’s projected 2002 test year adjustment at page 25 of his testimony as follows:

A recent review of Company procedures indicated that some areas of the main and service-line extension policy were being inconsistently applied. Consistent application of current tariff provisions is reasonably expected to increase CIAC by \$1,620,000. Under the current practice of recording CIAC as revenues, these adjustments have been added to system other revenues. In his testimony, Barrie L. McKay proposes to change the accounting of CIAC to a reduction in rate base. Until that proposal has been approved, these amounts are properly reflected in the revenue area.

The Company makes this adjustment, increasing projected 2002 Other Revenues by \$1.62 million. However, it did not make a similar adjustment to the 2001 test year.

Q. HAVE YOU SEEN ANY ADDITIONAL INFORMATION REGARDING THE

COMPANY'S INCONSISTENT APPLICATION OF ITS MAIN AND SERVICE-LINE EXTENSION POLICY?

- A. Yes. The Company's internal auditors conducted a review of this very same issue. According to the internal audit report, the Company had not changed the price of pipe charged to customers for service and main lines exceeding the footage allowance in over eleven years. The Company's current tariffs state that the charges for the pipe exceeding the footage allowances are to be determined by the average system cost of service during the most recent twelve-month period for which data is available. The Company's failure to update these charges in over eleven years, despite the fact the tariffs require it to do so, would have a significant impact on the amount of Contributions In Aid of Construction (CIAC) collected by the Company. In fact, the Company even formed an internal Committee to investigate this issue.

Company Witness Barrie L. McKay also addressed this issue in his testimony. At pages 3 and 4 of his testimony, he indicates that when an existing main and/or service line must be extended to serve a new customer, the customer is given a footage allowance based on the type and number of gas appliances installed. He indicates that the installation cost required beyond the footage allowance must be contributed by the customer. Customers are also required to pay certain excess construction costs, such as rights-of-way, permit fees, overtime required, etc. Mr. McKay then indicates, consistent with the internal audit report, that some of the tariff provisions in the area of excess construction costs and excess service line contributions have not been uniformly applied by the Company.

- Q. SHOULD THE COMPANY'S ADJUSTMENT TO REFLECT THE INCREASE IN CONTRIBUTIONS IN AID OF CONSTRUCTION RESULTING FROM CONSISTENT APPLICATION OF ITS CURRENT TARIFF PROVISIONS ALSO BE REFLECTED IN THE HISTORICAL TEST YEAR?**

- A. Yes. The current tariff provisions were in effect during the entire 2001 test year. Existing customers should not be penalized because the Company was not following its specific tariff provisions when connecting new customers. Consequently, the adjustment made by the Company to reflect the consistent application of the current tariff provisions should also be made to the 2001 test year for purposes of determining the revenue requirement in this case. I have reflected this Company calculation on CCS Exhibit 3.1.3, increasing 2001 test year “other revenues” account by \$1.62 million.

Gain on Sale of Property

Q. PREVIOUSLY IN THIS TESTIMONY YOU ADDRESSED THE COMPANY’S SALES OF SEVERAL PROPERTIES. DO THESE SALES RESULT IN THE NEED FOR ADDITIONAL ADJUSTMENTS?

- A. Yes. The Company’s adjustment to the Results of Operations appropriately removed the sold properties from rate base and depreciation expense. However, it failed to consider the gains associated with these sales. These sold properties had been devoted to utility service, and the Company’s ratepayers paid for these properties via the inclusion of these properties in plant in service and plant held for future use. Therefore, the customers should also receive some of the benefit resulting from these properties being sold. In the prior rate case, Docket No. 99-057-20, the Committee recommended that the gain on sale be based on the actual amount of gain in the historical test year. A stipulation was entered into in that case resulting in an amortization of that gain over a number of years. Since the Company has demonstrated a long history of regularly selling properties (as evidenced in Exhibit 5.7 of the Company’s Results of Operations), I recommend a gain on sales be reflected in the revenue requirement calculation based on a historical average level. The amount of gain varies from year-to-year, therefore, my recommend approach will set a more normal level for gains on property sales.

**Q. HAVE YOU PRESENTED A SCHEDULE REFLECTING YOUR
RECOMMENDED ADJUSTMENT?**

- A. On CCS Exhibit 3.3.1, I present each of the sales along with the associated gain for all sales occurring during the period 1999 through 2001. As shown on the exhibit, the Company had total gains on sales of property in 1999 of \$930,036. The net gains in 2000 and 2001 were \$231,963 and \$748,673, respectively. The average net gain over this three-year period was \$636,891, or \$612,180 on a Utah allocated basis. I have reflected this recommended average gain on CCS Exhibit 3.1.3 for the 2001 test year and on CCS Exhibit 3.2.3 for the 2002 test year.

Increase In Revenues - Industrial Customers

**Q. ARE ANY ADDITIONAL ADJUSTMENTS TO 2002 TEST YEAR REVENUES
NECESSARY?**

- A. Yes. As shown on CCS Exhibit 3.2.3, 2002 test year revenues should be increased an additional \$121,104.

Q. WHAT IS THE PURPOSE OF THIS ADJUSTMENT?

****BEGIN CONFIDENTIAL****

- A.

****END CONFIDENTIAL****

RECOMMENDED OPERATING EXPENSE ADJUSTMENTS

Q. DO YOUR RECOMMENDED ADJUSTMENTS TO OPERATING EXPENSE IMPACT THE HISTORICAL TEST YEAR, THE PROJECTED TEST YEAR, OR BOTH?

A. Since the expenses included by QGC in the projected test year are based on the historical test year expenses, with some minor revisions, the majority of the adjustments affect both the 2001 test year and the 2002 test year. In the limited circumstances in which an expense adjustment impacts only one test year, I specifically point this out. Each of my exhibits also identifies at the top which test year is impacted. Finally, in the event the Commission determines that a year-end

test year methodology should be utilized, most of the expense adjustments I am sponsoring would remain the same.¹

Distrigas Allocation - 2001

Q. ARE THERE ANY ADJUSTMENTS THAT QGC MADE TO THE PROJECTED 2002 TEST YEAR THAT SHOULD BE REFLECTED IN YOUR RECOMMENDED AVERAGE 2001 TEST YEAR?

A. Yes. The first such adjustment pertains to the distrigas annualization. The distrigas allocation methodology is used by Questar Corporation to allocate charges among its various affiliates, including QGC. According to page 27 of Company Witness Gary Robinson's testimony, the distrigas expense allocation percentages are calculated at the end of each year for use in the following year. On Exhibit QGC 4.6, page 12, the Company makes an adjustment to 2001 allocated expenses to reflect an updated distrigas allocation percentage. According to the exhibit, the weighted average 2001 distrigas allocation percentage to QGC was 29.54%. The adjustment revises this percentage downward to 27.46%. The schedule also adjusts the amount of distrigas allocation percentage relating to Questar Regulated Services (QRS) -- which is subsequently allocated further downward to QGC. For example, the exhibit identifies the weighted average 2001 distrigas percentage allocated to Questar Regulated Services at 7.01%. In updating the distrigas percentage, it revises this amount downward to 5.87%.

Q. WHAT CAUSED THE DISTRIGAS ALLOCATION PERCENTAGES CHARGED TO QGC AND QUESTAR REGULATED SERVICES TO DECLINE SO MUCH BETWEEN THE AVERAGE 2001 AMOUNT TO THE 2002 ALLOCATION

¹A notable exception is depreciation expense.

PERCENTAGES?

- A. According to page 27 of Company Witness Robinson's testimony, part of the reason for the decrease in the allocation percentage is the recent acquisition of Shenandoah Energy, Inc. by Questar Market Resources. Despite the acquisition occurring in 2001, Shenandoah Energy, Inc. was not included in the 2001 distrigas calculation. The impact was reflected beginning in 2002.

Q. SINCE THE CHANGE IN THE DISTRIGAS CALCULATION DID NOT OCCUR UNTIL AFTER THE HISTORICAL TEST YEAR, WHY DO YOU RECOMMEND THAT THE IMPACT OF THE UPDATE TO THE FORMULA BE REFLECTED IN YOUR RECOMMENDED 2001 TEST YEAR?

- A. The main cause of the decline in the allocation percentage ultimately being charged to QGC appears to be due to the acquisition of Shenandoah Energy, Inc. This acquisition, along with QGC's acquisition of Utah Gas Services Company, both occurred in July of the 2001 test year. It is therefore appropriate to reflect the updated distrigas allocation percentage in determining the amount of Questar Corporation allocated costs to be included in the revenue requirement calculation. The distrigas allocation calculated at the beginning of 2002 is based on 2001 amounts. The impact of the Company's update of the distrigas percentage calculation on 2001 Questar Corporation allocated costs results in a \$463,000 reduction to QGC's expenses, as calculated by the Company. On CCS Exhibit 3.1.4, page 2, Column A, I reflect this \$463,000 reduction. As previously indicated, this adjustment only impacts the 2001 test year because the Company has already reflected the impact in the 2002 test year.

Remove New Employees

Q. ARE YOU RECOMMENDING ANY EXPENSE ADJUSTMENTS THAT IMPACT THE 2002 TEST YEAR, BUT NOT THE 2001 TEST YEAR?

- A. Yes. As part of its new customer additions adjustment presented in Exhibit QGC 4.6, pages 2A through 2C, the Company added \$458,208 to expense in the projected 2002 test year for the addition of twelve (12) new employees. In his testimony at page 22, Company witness Robinson indicates that these 12 new operating employees are needed to maintain the current level of customer service and to provide for the additional customers. The employees proposed to be added in the adjustment are five technical service employees, four call center/dispatch employees and three billing/meter reading employees. I recommend that this adjustment be removed. On CCS Exhibit 3.2.4, page 2, column F, I reduce projected 2002 expense by \$458,000 to remove these costs.

Q. WHY DO YOU RECOMMEND THAT THIS COMPANY ADJUSTMENT BE REMOVED?

- A. While the Company has projected in the filing that it would need to add 12 more employees to serve new customers during 2002, the actual employee levels have stayed the same, at least through the most recent month I have information on. In response to CCS 1.30, the Company provided the actual and budgeted full-time equivalent (FTE) employee counts for QGC for each month in the period January 2000 through May 2002. The actual FTE employee count is exactly the same in May 2002 (the most recent month for which information was provided) as it was in December 2001, at 795 employees. Customer growth would have occurred over this same period in which the overall FTE employee level has remained the same.

Additionally, one of the Company's affiliates (QES) occasionally uses QGC's employees. QGC allocates costs to QES for this use of QGC employees.

According to the response to CCS 10.43, the total amount of employee costs charged to QES from QGC for the entire year of 2001 was \$142,510. During the first six months of 2002, the amount charged was \$160,030. Apparently, QGC

employees have been able to do significantly more work for QES in 2002 than in 2001. Considering QGC's employee level was the same as of the end of May 2002 as it was in December 2001 and QGC employees have been available during that same time to perform more services for an affiliated Company, the Company has not demonstrated that its proposed 12 employee increase is necessary or has actually occurred.

Advertising Expense

Q. YOU PREVIOUSLY ADDRESSED A CORRECTION THAT NEEDS TO BE MADE TO THE 2002 TEST YEAR FOR ADVERTISING EXPENSE. ARE YOU RECOMMENDING ANY FURTHER ADJUSTMENTS TO THE COMPANY'S PROPOSED ADVERTISING EXPENSE IN THIS CASE?

A. Yes. In its filing, QGC made several adjustments to the 2001 test year advertising expense level to remove items related to promotional, institutional, and general advertising. However, there are additional advertising costs that should also be removed.

Q. WHAT ADDITIONAL ADVERTISING COSTS SHOULD BE REMOVED?

A. Two items that the Company has classified as informational advertising should also be removed. In response to CCS 1.3, the Company identified \$6,153 included in the adjusted test year informational advertising expense associated with what it has titled "Employee/Reliability/Value Campaign." In response to CCS 4.8C, the Company indicated that the "Employee/Reliability/Value" advertising campaign was promotional advertising and that the related costs were removed from the test year. However, this response conflicts with the response to CCS 1.3, which indicates the costs associated with this program remain in the test year. Moreover, the amount can be traced to the Company's advertising expense remaining in the test year on Exhibit QGC 4.4, page 16. As the Company has acknowledged that this

advertising campaign is promotional and should be removed from the test year, I have removed the associated amount on CCS Exhibit 3.3.2, line 1.

The next informational advertising expense I recommend removing consists of \$15,224 the Company has identified as new customer information meetings. In response to CCS 4.8, the Company agreed that these advertising costs were associated with the Utah Gas Services Company acquisition. During my on-site review at the Company's offices, QGC provided copies of actual advertisements included in the 2001 test year period. These advertisements included an advertisement for a free community barbecue that would fall under this new customer information meeting expense. I recommend that these new customer information meeting advertisement expenses totaling \$15,224 be removed. Since these costs are related to the Utah Gas acquisition, they are nonrecurring in nature. Additionally, the expense is for promotional purposes.

Q. ARE THERE ADDITIONAL ADVERTISING COSTS THAT SHOULD BE REMOVED?

- A. In Exhibit QGC 4. 4, page 16A, the Company identified \$123,855 of financial advertising costs being allocated to QGC. According to the data response to CCS 1.3, the \$123,855 represents the portion of costs allocated to QGC from Questar Corporation's total of \$369,706. Copies of these advertisements were provided for review during the on-site visit. The advertisements consist of fact sheets which are placed in various financial magazines, such as Buyside, Research, On WallStreet, and Oil & Gas Investor. The fact sheets provide information concerning Questar Corporation that would be of interest to potential investors in the Company. The fact sheets serve to promote the Company's image to investors and should be financed by the Company's shareholders. These costs should not be allocated to the Company's ratepayers.

Q. WHAT IS THE OVERALL IMPACT OF YOUR RECOMMENDED ADJUSTMENTS TO ADVERTISING EXPENSE?

- A. As shown on CCS Exhibit 3.3.2, advertising expense should be reduced by an additional \$145,232. This reduction in expense has been reflected in both the recommended 2001 average test year and the average 2002 test year.

Postage Expense

Q. ARE YOU RECOMMENDING ANY ADJUSTMENT TO THE AMOUNT OF POSTAGE EXPENSE INCLUDED IN EITHER THE 2001 TEST YEAR OR THE 2002 TEST YEAR?

- A. Yes. I am recommending two separate adjustments. The first adjustment only impacts the 2001 test year. The second adjustment relates to the 2002 test year to correct for an error in the Company's calculations.

Q. WOULD YOU PLEASE ADDRESS YOUR FIRST ADJUSTMENT FOR POSTAGE EXPENSE IMPACTING THE 2001 TEST YEAR?

- A. On Exhibit QGC 4.4, page 23, the Company first made an adjustment to reduce postage expense by \$313,379 to remove the types of mailings and inserts that were specifically disallowed in the Company's previous case. The Company made the same adjustment in its Results of Operations for the period ending December 31, 2001. I agree that this adjustment is appropriate. However, an additional adjustment is warranted. In Exhibit QGC 4.6, at page 9, the Company made an additional adjustment to reflect the actual increase in postage rates that occurred on June 30th of this year. That exhibit identifies the recalculated postage costs for the 2001 test period as \$2,679,309 after taking into consideration the impact of the postage increases. The actual postage charges during the historical test year were \$2,452,449. In other words, the increase in postage resulted in a \$226,860

incremental increase in postage expense due entirely to the postage increase that went into effect June 30, 2002.

Although the increase in postage rates occurred subsequent to the historical test year, I nonetheless recommend that this actual increase in postage rates be reflected in the historical test year. This post-test year revision pertains to a change in prices only, not a change in volume of postage. However, this \$226,860 increase in postage expense needs to be reduced for the percentage of postage expense disallowed, based on the actual mailings/inserts specifically excluded by the Company in its 2001 test year adjustment.

Q. PLEASE EXPLAIN.

A. My recommended calculation for postage expense is reflected on CCS Exhibit 3.3.3. At the bottom of that exhibit, I have calculated the actual percentage of 2001 test year postage cost specifically removed by the Company in its filing, resulting in a 12.78% removal. This 12.78% removal should also be applied to the increase in postage expense. As shown on line 5 of the exhibit, the amount of postage increase that would be disallowed due to being associated with disallowed postage costs is \$28,993. This results in an allowable postage increase of \$197,867, which I have reflected in CCS Exhibit 3.1.4.

Q. YOU STATED THAT THE AMOUNT OF POSTAGE EXPENSE ADJUSTMENT REFLECTED BY THE COMPANY IN ITS 2002 TEST YEAR CONTAINED AN ERROR THAT NEEDS TO BE CORRECTED. COULD YOU PLEASE ELABORATE?

A. In calculating its 2002 postage expense increase to acknowledge the impact of the postal rate increase on Exhibit QGC 4.6, page 9, the Company calculated its projected postage expenses based on actual 2001 mailings and 2002 postal rates,

totaling \$2,679,309. From this amount it then subtracted its adjusted 2001 postage cost of \$2,139,070. This \$2,139,070 being subtracted is the adjusted postage expense included in the 2001 test year which includes the removal of the disallowed postage items. In other words, by basing the adjustment on the difference between the projected postage expense reflecting all mailings in 2001 and the postage rate increase and the net adjusted amount, the Company has effectively added in not only the impact of the postal rate increase, but also the full amount it would have removed in the historical test year for the disallowed mailings. On CCS Exhibit 3.3.3, I calculate a corrected postage increase adjustment for the 2002 test year. This calculation reflects the allowable incremental postage increase previously discussed of \$197,867 less the adjustment included by the Company in its filing of \$540,239. This results in a required adjustment of \$342,372 to the 2002 test year. If this reduction is not reflected in the 2002 test year results, the Company would effectively be allowed to recover the postage associated with the specific items that the Commission determined should be disallowed in the previous case. Based on a review of the Company's testimony in this case and on Exhibit QGC 4.6, page 9, it appears that this is simply an error in the Company's calculation.

AGA Membership Dues

- Q. IN ITS FILING, QGC REDUCED THE AMOUNT OF AMERICAN GAS ASSOCIATION DUES INCLUDED IN THE 2001 TEST YEAR BY 2.01%, OR \$4,481, TO REMOVE THE PERCENTAGE OF AMERICAN GAS ASSOCIATION (AGA) DUES SPENT FOR LOBBYING DURING 2001. SHOULD ANY ADDITIONAL ADJUSTMENTS BE MADE TO THE AGA DUES EXPENSED IN THE 2001 TEST YEAR?**
- A. Yes. In addition to lobbying expense, the AGA spends significant amounts on government relations. According to a definition of functional cost centers of the AGA for the year ended December 31, 1998, the government relations cost center

provided members with information on legislative and regulatory developments; prepared testimony, comments and filings regarding legislative and regulatory activities; and lobbies on behalf of the industry. Thus, I recommend that the entire portion of AGA dues related to government relations be removed.

Q. WHAT PORTION OF AGA MEMBERSHIP DUES ARE USED FOR GOVERNMENT RELATIONS?

- A. Historically, NARUC has conducted annual audits on the expenditures of the American Gas Association. As part of the audit report, the percentage of AGA costs going to each functional group or category was specifically identified. The last report on the expenditures of the AGA conducted by NARUC of which I am aware was for the year ended December 31, 1998. At that time, 23.86% of AGA expenditures pertained to government relations. Since this is the most recent audit of the expenditures of which I am aware, I recommend that 23.86% of AGA membership dues be removed. As shown on CCS Exhibit 3.3.4, this would result in an additional reduction of AGA dues expense of \$48,710, resulting in a net reduction to AGA dues of \$53,191. I have reflected this approximate \$49,000 reduction in expense in both the 2001 test year and the 2002 test year.

Y2K Amortization Expense

Q. PLEASE DISCUSS THE COMPANY'S ADJUSTMENTS TO THE 2001 HISTORICAL TEST YEAR AND ITS PROJECTED 2002 TEST YEAR FOR Y2K EXPENSE.

- A. On Exhibit QGC 4.3, the Company makes an adjustment to increase 2001 test year expense by \$546,000 to reflect a three-year amortization of Y2K expenses incurred during 1999 and 2000. The 1999 costs totaled \$1,449,524, resulting in an annual amortization for 1999 costs of \$483,175. The costs incurred in 2000 totaled \$189,732, resulting in an annual amortization for the 2000 costs of \$63,244. At

page 14 of his testimony, Mr. Robinson indicates that the Company agreed in the stipulation in Docket No. 99-057-20 to amortize the Y2K expenses over a three-year period. The adjustment to the 2001 test period proposed by the Company increases Y2K amortization expenses by \$546,000 (\$483,175 for 1999 costs and \$63,244 for 2000 costs). This purportedly results in one year's amortization of the total Y2K expenses being included in the adjusted historical test year. In Exhibit QGC 4.5, Column 11, the Company subsequently makes an adjustment to the 2002 test year to then remove the \$546,000 it added. At page 26 of his testimony, Mr. Robinson indicates that the item is being removed because the amortization will end in 2002 and will have ceased by the time rates become effective in 2003. There is a significant error in these Company adjustments.

Q. PLEASE EXPLAIN.

A. The Company's first adjustment adds a full year's worth of amortization to the 2001 test year. This would have to assume that there was zero expense recorded in the historical test year for Y2K costs. However, based on a review of the general ledger detail for Account 921 for Questar Gas Company, there was a total of \$583,000 recorded during the 2001 test year with the description "Clear Y2K Costs." The total amount consisted of monthly charges of \$48,583.34 each. Prior to the Company's adjustments having been made, the amount actually recorded during the historical test year should have first been removed. To do otherwise would result in a double counting of these costs: once by inclusion of Y2K costs on the 2001 books; and an additional time as an adjustment to expenses in the Company's filing.

Q. IS QGC AWARE OF THIS PROBLEM?

A. Yes. In response to CCS 18.1, the Company agreed that its adjustment was incorrect and results in the double counting of these expenses. On CCS Exhibit 3.3.9 I remove the \$583,000 already recorded on QGC's books during the 2001

test year to avoid the double counting of these costs.

Q. ARE YOU RECOMMENDING ANY ADDITIONAL REVISIONS TO THE COMPANY'S ADJUSTED Y2K AMORTIZATION EXPENSE?

- A. Yes. I recommend that the portion of the amortization associated with costs incurred during 2000 be removed. Company Witness Gary Robinson indicates in his testimony that: "As part of the stipulation approved in Docket No. 99-057-20, the Company agreed to amortize these Y2K expenses over a three-year period." This is correct with regards to the Y2K costs incurred during the test year utilized in that case, i.e., the year ended December 31, 1999. However, the stipulation approved by the Commission did not address the 2000 Y2K costs, nor did the Commission's Order allow the Company to defer the Y2K costs incurred during 2000. The Report and Order in Docket No. 99-057-20, issued August 11, 2000, specifically addressed the Y2K costs under the "Undisputed Issues" section as follows:

During 1999, Questar Gas incurred charges of about \$1,449,000 from Questar InfoComm for projects related to Y2K preparation and program modifications. This adjustment amortizes these expenses over a three-year period, allowing recovery of about \$483,000 annually. It reduces expenses by \$966,363.

The Company apparently did not seek and was not granted permission to defer the Y2K costs incurred in 2000. That year (2000) was not a test year used in a rate case proceeding, and the Company did not request permission to defer these amounts in its last rate case proceeding. I recommend that the Company's proposed amortization of the Y2K costs incurred in 2000 be removed, reducing amortization expense by \$63,244.

Q. HAVE YOU PREPARED AN EXHIBIT SHOWING YOUR RECOMMENDED ADJUSTMENTS TO QGC'S Y2K AMORTIZATION EXPENSE?

- A. Yes. My recommended adjustments are presented in CCS Exhibit 3.3.9, reflecting

the \$583,000 correction and the removal of \$63,244 for the amortization of costs incurred in 2000. As shown on line 3 of CCS Exhibit 3.3.9, QGC's adjusted 2001 test year and 2002 test year expenses should be reduced by \$646,244.

Incentive Compensation

Q. ARE THERE ANY PROBLEMS WITH THE INCENTIVE COMPENSATION ADJUSTMENTS MADE BY THE COMPANY IN BOTH THE RESULTS OF OPERATIONS FOR THE PERIOD ENDING DECEMBER 31, 2001 AND IN THE COMPANY'S FILING?

A. Yes. Numerous revisions need to be made to the Company's incentive compensation calculations; in particular for the QGC incentive pay adjustments in both the Results of Operations and in the filing. I would like to first note though that the Company made a significant revision to the incentive compensation adjustment specific to QGC in its Results of Operations for the period ended December 31, 2001. In its filing, in Exhibit QGC 4.4, page 20c, the Company included an overhead factor in the calculation of 19.45%. The Company has indicated in a data response that this 19.45% was based on the stipulation entered into in the previous rate case. However, in its Results of Operations, the Company increased this overhead factor to 33.70%. This resulted in a significant increase in the amount of incentive compensation expense that the Company left within the 2001 test year. I will address the Company's application of the overhead percentage in further detail later in this section of testimony. Beyond the overhead rate application issue, there are also numerous corrections that need to be made to the Company's calculation. The Company has agreed to the majority of these corrections in response to various data requests.

Q. HAVE YOU PREPARED AN EXHIBIT TO CALCULATE YOUR RECOMMENDED INCENTIVE COMPENSATION EXPENSE ADJUSTMENT?

- A. Yes, CCS Exhibit 3.3.5 shows my recommended adjustments to incentive compensation expense. This exhibit is calculated similar to the Company's exhibits for the Questar Gas Incentive Pay adjustment, with various corrections and revisions.

Q. WOULD YOU PLEASE FIRST ADDRESS THE CORRECTIONS THAT NEED TO BE MADE TO THE CALCULATION THAT THE COMPANY HAS AGREED TO?

- A. The first two corrections that need to be made are for the QGC Management Incentive Plan (AMIP). In both the Results of Operations and in its filing, the Company included percentage allocations between financial goals and O&M goals for this AMIP plan. In both cases, the Company utilized 51.14% as the financial goals and 48.86% as the O&M goals. The Company then essentially removed the percentage that was related to financial goals. In response to CCS 10.1, the Company indicated that the percentages included in the exhibits were incorrect. The response specifically indicates that after reviewing the calculations, the Company determined that the AMIP weighting for the 2001 payout should have been 76% to financial goals and 24% to operational goals. On CCS Exhibit 3.3.5, I revised the calculation to reflect the corrected weighting between the financial goals and the O&M goals.

The next error in the AMIP plan calculation on the Company exhibits relates to the total AMIP dollar payout included. In the Results of Operations, the Company included \$457,892 as the total payout. In Exhibit QGC 4.4, page 20C of its filing, the Company included \$409,089 as the AMIP dollar payout for 2001. In response to DPU 4.2, QGC indicated that the earned AMIP amount for 2001 of \$396,117 should have been used in the filing as opposed to the actual payout it used in its calculation. Consequently, I have replaced the AMIP dollar payout amounts included

in the Company's exhibits with the corrected earned amount of \$396,117. As shown on line 2 of CCS Exhibit 3.3.5, \$95,068 should be allowed for QGC's AMIP, based on the corrected percentage related to O&M goals.

Q. TURNING TO QGC'S EMPLOYEE INCENTIVE PLAN, PLEASE BRIEFLY DISCUSS THE COMPANY'S PROPOSED ADJUSTMENTS?

- A. In its calculations to adjust the QGC employee incentive plan (PIPE) the Company determined the payout percentage applicable to financial goals and the percentage payouts applicable to operating goals. The total 2001 PIPE percentage payout was 5.24% of payroll costs. Of the 5.24% total, the Company contends that 1.58% pertains to financial goals and 3.66% pertains to operating goals. In determining its proposed PIPE expense, the Company applied the 3.66% operating goals to the QGC and allocated QRS payroll base.

Q. ARE YOU RECOMMENDING ANY REVISIONS TO THE PERCENTAGE PAYOUT?

- A. Yes. The Company contends that 3.66% is the correct portion of operating goals. However, in response to DPU 1.2, the Company provided copies of the actual plan. One of the main features of the PIPE program has changed since the Company's last rate case proceeding. The Company describes the change in response to DPU 4.7. According to the response, in 2001 the 1% bonus that used to be in the plan for meeting all three operating goals at the target level was eliminated. This was replaced with a new operating goal for capital productivity. The Company has included this capital productivity goal as an O&M goal which it included in adjusted expenses in the case. I recommend that the costs associated with this new capital productivity goal be removed.

Q. WHY DO YOU RECOMMEND THAT THE COST ASSOCIATED WITH THE

**CAPITAL PRODUCTIVITY GOAL INCLUDED IN THE PIPE PROGRAM BE
REMOVED?**

- A. I disagree with the Company's claim that the capital productivity goal is an operating goal. This goal should be included with the financial goals that the Company has specifically excluded in this case. In response to DPU 1.2, the Company provided a copy of its actual PIPE program that was in effect during the 2001 test period. This same plan would also be in effect during 2002. When describing the capital productivity goal, the plan specifically provides the following description:

The third operating goal is capital productivity. This goal reflects how efficiently we earn on our investment in assets the Company owns, such as pipes and valves, computers and systems, vehicles, building, and property. Capital productivity is calculated by dividing our income-before income taxes and interest costs are deducted-by the total average value of our assets. Performance on this goal can be improved by reducing costs, increasing revenues, avoiding non-revenue producing capital asset purchases and investing in assets that provide a return equal to or higher than our target goal.

Since the focus of the goal is to increase the return on investment, this goal is clearly financial in nature and would serve to benefit shareholders. In fact, within the actual plan, after the title "Capital Productivity," the Company has in parenthesis "Return on Assets." In response to CCS 7.13, the Company provided quarterly progress reports on its results in achieving the PIPE program goals for 2002 to date. When addressing the first quarter capital productivity or return on assets goal, the document provided specifically indicates that the goal "Helps us focus on earning a competitive return on the things we invest Company resources in...."

In this case, the Company has specifically removed the percentage payout relating to financial goals. The financial goals are based on net income. This capital productivity goal is similar in nature to the financial goals.

Q. WHAT ADJUSTMENT NEEDS TO BE MADE TO REMOVE THE PAYOUT ASSOCIATED WITH THE CAPITAL PRODUCTIVITY GOALS?

A. In response to DPU 1.2, the Company provided a breakout of each of the individual goals that sum to the total operating goals of 3.66%. According to this document, the amount related to capital productivity is 0.60%. As shown on CCS Exhibit 3.3.5, on line 5, I removed the 0.60% from the 3.66% operating goals, resulting in revised and allowed operating goals of 3.06%.

Q. PLEASE CONTINUE WITH YOUR DISCUSSION OF CCS EXHIBIT 3.3.5.

A. As shown on lines 6 through 8 of that exhibit, I then applied the 3.06% allowable operating goals to the 2001 QGC and allocated QRS payroll base. This results in operating goal dollar payouts for the QGC employee incentive plan (PIPE) of \$1,286,179. When combined with the allowable AMIP (management incentive plan) amount of \$95,068, this results in a total AMIP and PIPE operating goal expense of \$1,381,247, as shown on line 9.

Q. IN ITS CALCULATIONS OF THE INCENTIVE PAY ADJUSTMENT, THE COMPANY THEN INCREASED THE TOTAL ALLOWABLE AMIP AND PIPE OPERATING GOAL PAYOUTS BY OVERHEAD FACTORS. DID YOU INCLUDE THIS OVERHEAD FACTOR IN YOUR CALCULATIONS?

A. No, I did not. In its calculations, the Company increased its adjusted AMIP and PIPE operating goal payouts by a 19.45% overhead factor in the filing and by a 33.70% overhead factor in its Results of Operations. The Company then took this grossed-up amount and subtracted the amount of expense recorded in Account 921 during the 2001 test year for the PIPE and AMIP. The gross-up of the calculated expense amount by an overhead factor is inappropriate and results in an over-recovery of these costs.

Q. PLEASE EXPLAIN.

- A. In CCS 10.5, the Company was specifically asked what the overhead factor was for and how the percentage was determined. In its response, the Company indicated that the 19.45% overhead rate included in the original filing needed to be updated to a 33.77% rate. The Company then also referred to its response to DPU 4.10. The response to DPU 4.10 provides a breakdown of the 33.77% rate. Included in the 33.77% is: FICA/Medicare of 7.65%; unemployment insurance of 0.14%; workers compensation of 5.2%; pension plan of 20.96%; and stock (employee savings) of 4.5%. Based on the way the Company has calculated its adjustment in both the Results of Operations and the filing, it is not appropriate to gross-up the amount by the overhead factor.

Q. WHY NOT?

- A. In calculating the overall adjustment, the Company subtracted the amounts recorded in FERC Account 921 for its PIPE and AMIP plan from the amount it calculated, which was grossed-up for overheads. This results in an apples-to-oranges comparison and would result in a double recovery of certain overhead costs. During the 2001 test year, costs associated with the items included in the overhead factor would have been recorded in accounts other than Account 921. FERC Account 921 is for Office Supplies and Expenses. Employment taxes such as FICA and medicare would have been recorded in the Company's books in Account 408 - Taxes Other Than Income Taxes. Pension expenses, which is the biggest component of the Company's overhead calculation, should have been recorded in Account 926 - Employee Pensions and Benefits. The same holds true for employee savings expenses. Since the Company is using only the amounts included in Account 921 expense during the 12-month period ended December 31, 2001 as an offset, it should not gross-up its calculated allowable amount by an overhead factor.

Q. WHAT IS THE OVERALL RESULT OF THE CORRECTIONS AND YOUR

**RECOMMENDED REVISIONS TO THE EMPLOYEE INCENTIVE PLAN
EXPENSES?**

- A. As shown on CCS Exhibit 3.3.5, the Company's 2001 Results of Operations should be reduced by \$974,676. As also shown on the exhibit, the 2002 test year amounts should be reduced by \$695,094. I have reflected each of these adjustments on CCS Exhibits 3.1.4 and 3.2.4, respectively.

Employee Removal

**Q. ARE YOU RECOMMENDING ANY ADDITIONAL ADJUSTMENTS TO
EMPLOYEE RELATED COSTS?**

- A. Yes. I recommend that test year labor costs be reduced by an additional \$65,000. This adjustment is made to the 2001 test year on CCS Exhibit 3.1.4, page 3, column K and to the 2002 test year on CCS Exhibit 3.2.4, page 3, column R.

Q. WHAT IS THE PURPOSE OF THIS ADJUSTMENT?

****BEGIN CONFIDENTIAL ****

A.

****END CONFIDENTIAL ****

Miscellaneous Outside Services Expense

Q. WHAT IS THE PURPOSE OF YOUR ADJUSTMENTS ON CCS EXHIBIT 3.3.6?

- A. Test year expenses include several costs that should not be charged to ratepayers. The Company has already agreed that several of these costs should be removed. The purpose of this exhibit is to remove both the costs the Company has already

agreed should be removed, and other costs for which I am recommending a disallowance. CCS Exhibit 3.3.6 includes those costs incurred by Questar Corporation which were subsequently allocated to QGC either directly, or indirectly through Questar Regulated Services.

Q. WOULD YOU PLEASE START WITH THOSE CHARGES THAT ARE ALLOCATED FROM QUESTAR CORPORATION?

- A. Yes. In response to DPU 1.4, the Company provided a spreadsheet listing the costs which were allocated to Questar Gas from Questar Corporation through the distrigas formula. Each of the allocated items that I am recommending for removal appear in that spreadsheet. The first two items listed are items the Company agrees should be removed. As indicated on the exhibit, one of the items pertains to a journal entry recording prior period expenses which should not have been included in 2001. In response to CCS 4.21, the Company indicated that \$60,351 charges from Sunlaw Energy Corporation should have been charged directly to QMR (an affiliated company), and therefore should be removed from the 2001 test year. Furthermore, in response to CCS 10.33 the Company indicated that Sunlaw Energy Corporation was used for its power team. The response also indicated that these costs should have been charged directly to QMR and should be removed from the test year. On line 3 of CCS Exhibit 3.3.6, I have removed the remaining Sunlaw Energy Corporation charges totaling an additional \$109,275 on a corporate basis. Also in response to CCS 10.33, the Company indicated that the charges from Lukas, Nace, Gutierrez & Sachs should have been billed directly to Questar InfoComm and should be removed from the 2001 test year. Based on a review of DPU 1.4, I determined that test year charges allocated via the distrigas formula for those services were \$10,173. I agree that the \$10,173 should be removed.

Q. YOU PREVIOUSLY INDICATED THAT THE COMPANY AGREED THAT THE

CHARGES FROM SUNLAW ENERGY CORPORATION THAT WERE USED FOR THE POWER TEAM SHOULD BE REMOVED. ARE THERE ANY ADDITIONAL COSTS THAT WERE ALLOCATED ASSOCIATED WITH THIS POWER TEAM?

- A. Yes, there are. In response to DPU 4.25, the Company indicated that it had established the power team to evaluate potential gas-fired generation projects. These costs should not be charged to Questar Gas Company's customers, and apparently the Company agrees. Relying on the Company's response to DPU 1.4, in which the costs that were allocated using the distrigas formula were listed, I was able to identify \$43,120 included in the 2001 test year associated with the power team. I removed these additional power team costs on line 5 of CCS Exhibit 3.3.6.

Q. WOULD YOU PLEASE DISCUSS THE REMAINING CHARGES FROM QUESTAR CORPORATION TO QUESTAR GAS COMPANY THAT YOU ARE RECOMMENDING BE REMOVED FROM THE 2001 TEST YEAR?

- A. Yes. Costs recorded and allocated during 2001 also include \$80,000 charged from Spencer Stewart, Inc. In response to CCS 10.33, the Company indicated that Spencer Stewart, Inc. is an executive search firm. During my on-site review at the Company's offices, I reviewed the actual invoice from Spencer Stewart, Inc. for \$80,000. The invoice indicated that the charge was for professional fees for September 2000. This appears to be a nonrecurring charge and also pertains to a period prior to the 2001 test year. Therefore, I recommend that the \$80,000 be removed.

The final group of allocated charges that I am recommending for removal all pertain to the Olympics. The Company has indicated in several places that costs associated with the Olympics were booked below-the-line. However, based on a review of the response to DPU 1.4 and on numerous invoices provided by the

Company, both as a result of my on-site visit and through discovery requests, I have identified numerous additional charges which remain in above-the-line accounts which were recorded during the 2001 test year. These costs relating to the Olympics total \$338,718 on a corporate basis. They include costs for the purchase of Olympic tickets, hotel accommodations related to Olympic hospitality, installments for sponsoring bus transportation related to the Olympics and Olympic venue hospitality passes. These costs should not be charged to the Company's customers. Consequently, I recommend they all be removed. I have listed each of the charges on CCS Exhibit 3.3.6.

Q. PLEASE DISCUSS THE QUESTAR COMPANY DIRECT CHARGES WHICH YOU ARE REMOVING.

- A. In response to CCS 18.2, the Company agrees that the items removed on lines 18 through 20 of CCS Exhibit 3.3.6 pertain to prior periods and should be removed. The next charge that I recommend be removed consists of \$40,000 paid to Economic Development Corporation. This contribution should not be in costs passed along to ratepayers.

As shown on CCS Exhibit 3.3.6, I recommend that costs directly charged to and/or allocated to QGC be reduced by \$645,169. This adjustment impacts both the 2001 and the 2002 test years.

Office Closure

- Q. PREVIOUSLY IN THIS TESTIMONY WHEN ADDRESSING THE SALES OF PROPERTY, YOU INDICATED THAT THE CEDAR CITY OFFICE WAS SOLD IN FEBRUARY 2002. DOES THE SALE OF THIS OFFICE RESULT IN ANY ADDITIONAL COST SAVINGS THAT SHOULD BE REFLECTED IN THE**

REVENUE REQUIREMENT CALCULATIONS?

- A. Since the office was not sold until February 2002, any costs savings would not impact the 2001 test year. In the event that the Commission determines that the 2002 test year should be adopted, the savings associated with the sale of this office should be reflected in the adjusted test year.

Q. WHAT ADJUSTMENT TO THE PROJECTED TEST PERIOD ARE YOU RECOMMENDING?

- A. According to the response to CCS 10.32, the direct operating cost for the Cedar City office during 2001 totaled \$70,692. The response also indicates that: "We estimate that approximately 50% of these costs will continue because the Cedar City office has been relocated to a smaller facility." Consequently, in the 2002 test year, 50% of the cost or \$35,000 needs to be removed. This adjustment should only be made if a 2002 test year is used in this case. I have reflected this reduction on CCS Exhibit 3.2.4, page 3, Column O.

Uncollectible Expense

Q. WOULD YOU PLEASE BRIEFLY DISCUSS THE COMPANY'S ADJUSTMENT FOR BAD DEBT EXPENSE?

- A. In previous QGC rate cases, the Commission has based bad debt expense on the three-year average percentage of net write-offs to average accounts receivable balances. In the Company's last rate case, the stipulation calculated to bad debt expense under the same three-year average methodology. The Company wishes to change this long-standing methodology in the current case. In this case, the Company is proposing to base the bad debt expense on the actual 2001 percentage of bad debt expense to total revenues for that same year, which is 0.9% of total revenues. It then proposes that this percentage be applied to the projected revenues in this case. Additionally, the Company removed the percentage of bad

debt expense that pertains to non-DNG revenues. The reason for this adjustment, as explained in Company Witness Gary Robinson's testimony at page 7, is that the Company proposed in Docket No. 01-057-14 to account for the bad debt expense related to SNG and commodity revenues in the 191 Account.

Q. DID THE COMMISSION'S ORDER IN DOCKET NO. 01-057-14, ISSUED AUGUST 14, 2002, APPROVE THE RECOVERY OF BAD DEBT EXPENSE RELATED TO SNG AND COMMODITY REVENUES THROUGH THE 191 ACCOUNT?

A. Yes, it did. Consequently, I agree that the bad debt expense recorded during the test year pertaining to SNG and commodity revenues should be removed. The Company will now have an opportunity to recover this portion of bad debt expense via the 191 Account.

Q. DO YOU AGREE WITH THE COMPANY'S PROPOSAL TO BASE BAD DEBT EXPENSE ON THE PERCENTAGE OF BAD DEBT TO TOTAL REVENUES REALIZED DURING 2001?

A. No. I recommend a three-year average methodology continue to be used. I recommend that adjusted test year bad debt expense be based on the three-year average of net write-offs to average accounts receivable. As shown on page 2 of CCS Exhibit 3.3.7, the three-year average percentage is 5.45%. Use of an average uncollectible factor smooths out fluctuations that occur from year to year causing uncollectible expense to be based on a normalized level.

Q. DID THE COMPANY PROVIDE TESTIMONY STATING WHY IT FEELS IT IS APPROPRIATE TO USE A ONE-YEAR LEVEL OF BAD DEBT RATHER THAN THE THREE-YEAR AVERAGE METHOD PREVIOUSLY ADOPTED BY THE COMMISSION?

- A. Yes, at page 7 of his direct testimony, Company Witness Gary Robinson states that bad debt expense has steadily and materially increased during the past three years. He further indicates that the trend is not expected to end, and that Utah has experienced a record number of bankruptcy filings in 2001. He then states that using a three-year average ignores these "clear trends."

Q. WOULD YOU PLEASE DISCUSS THESE ASSERTIONS?

- A. On CCS Exhibit 3.3.7, page 2, I provide the annual net write-offs in the annual average accounts receivable balances, along with the resulting percentage of net write-offs to receivables, for each of the years from 1995 through 2001. For the last three-years, the percentage of net write-offs to receivables actually declined between 1999 and 2000, from 5.27% to 4.45%. That percentage then substantially increased between 2000 and 2001 from the 4.45% in 2000 to 6.62% in 2001. As shown on the exhibit, the percentage net write-offs to receivables fluctuates from year-to-year. Some years it increases, while other years it actually declines. This exhibit further demonstrates why the use of an average is more appropriate for setting rates.

Q. ARE THERE ANY ADDITIONAL REASONS WHY A BAD DEBT PERCENTAGE LEVEL SHOULD NOT BE BASED SOLELY ON 2001 AMOUNTS AS PROPOSED BY THE COMPANY?

- A. Yes. During 2001 there was a significant spike in gas commodity costs which has subsequently declined. In his direct testimony, Company Witness Hugh Larkin, Jr. addresses two anomalies that occur during 2001. These consist of a recession and the significant spike in gas prices. Each of these anomalies would likely have a significant impact on the level of uncollectibles realized by the Company during 2001. It would not be appropriate to base bad debt expense for the rate-effective period on the level recorded by the Company during 2001 because that would not

be reflective of historical levels. Consequently, I recommend that the Commission continue to adopt a three-year average percentage write-offs to average accounts receivable balance to determine the DNG portion of uncollectibles expense.

Q. WHAT ADJUSTMENT SHOULD BE MADE TO THE COMPANY'S PROPOSED UNCOLLECTIBLE EXPENSE TO REFLECT THE THREE-YEAR AVERAGE NET WRITE-OFF TO RECEIVABLES LEVEL?

- A. On page 1 of CCS Exhibit 3.3.7, I first applied the three-year average percentage write-offs of 5.45% to the 2001 average accounts receivable balance. This results in an uncollectible expense of \$4,516,851. Since the Company recovers the bad debt expense associated with SNG and commodity revenues via the 191 Account, I then applied the percentage of actual 2001 DNG revenue related bad debt expense to total bad debt expense for 2001 of 29.6%.² This results in my recommended DNG related uncollectible expense of \$1,317,114, which is \$567,961 less than the uncollectible expense included in the Company's Results of Operations.

Rate of Return Adjustment from Affiliates

Q. THE COMPANY'S FILING CONTAINS AN ADJUSTMENT TO REDUCE THE RATE OF RETURN CHARGED FROM AFFILIATED COMPANIES. DOES THE COMMITTEE'S RATE OF RETURN ON EQUITY RECOMMENDATION IMPACT THE ADJUSTMENT?

- A. Yes. In calculating the adjustment to reduce the return charged from affiliates, specifically Questar Corporation, Questar Regulated Services and Questar InfoComm (QIC), the Company applied its current allowed return on equity of 11.0%. CCS Witness David Parcell is recommending a lower return on equity of 10.0%. On CCS Exhibit 3.3.8, pages 2 through 5, I replace the return on equity in the

²Refer to Exhibit 3.3.7 for the derivation of 29.6%.

Company's calculations with the Committee's recommended return on equity of 10.0%.

Q. ARE YOU MAKING ANY ADDITIONAL REVISIONS TO QGC'S AFFILIATE COMPANIES RETURN ADJUSTMENT?

A. Yes. The overall impact of my recommended adjustments to the affiliate return is a reduction to the 2001 test year Results of Operations of \$343,966, and a reduction to QGC's adjusted 2002 test year of \$367,841. This is shown on page 1 of CCS Exhibit 3.3.8. The first change I recommend pertains to the rate of return charged to QGC from Questar Corporation, which I calculate on CCS Exhibit 3.3.8, page 2 of 5. As the starting point of my calculation, I use QGC's average 2001 gross asset and accumulated depreciation based on the Company's Results of Operations. I apply the Committee's recommended pretax return on net investment to Questar Corporation's average net investment amount of \$1,033,862. This approach is consistent with the methodology used by the Company. The difference between my calculations and the Company's, other than using a different rate of return, is that the Company subtracted its proposed adjustment from a calculated Questar Corporation return charged to QGC during 2001, rather than the amount actually charged and booked by QGC during 2001.

Q. PLEASE EXPLAIN.

A. In its Results of Operations, at Exhibit 5.13, Workpaper 1, the Company identified the annual return charged from Questar Corporation during 2001 as \$215,732. In its filing, at Exhibit QGC 4.4, page 13B, the Company identified the annual return charged from Questar Corporation during 2001 as \$226,704. The beginning point in both the Company's filing and its Results of Operations is the actual 2001 booked amounts, which are then adjusted. Consequently, the actual amount recorded on QGC's books during 2001 for the charges should be used in calculating the amount

of necessary adjustment. Questar Corporation charges the return on its assets to its affiliates in Journal Entry 692. The actual amounts recorded during 2001 by Questar Corporation in the 692 Journal Entries were \$234,732.50. It is this amount that should be used (i.e., the actual booked amount) in determining the adjustment. On CCS Exhibit 3.3.8, page 2 of 5, I calculate the difference between the amount actually booked by Questar Corp and allocated through the distrigas formula of \$234,733 and \$115,984--which is the allowable return on the average net investments based on the Committee's recommended rate of return on equity. This results in a \$118,749 reduction to the actual historical test year amount of booked costs. On lines 7 through 9 of the exhibit, I then determine the amount of adjustment applicable to QGC using the same method the Company used in its adjustment.

Q. WHAT REVISIONS HAVE YOU MADE RELATING TO CHARGES ALLOCATED FROM QRS?

A. The adjustment applicable to the charges allocated from QRS is presented on page 3 of CCS Exhibit 3.3.8. This exhibit follows the exact same methodology and uses the same numbers used by QGC in its adjustment, with the exception of replacing the pretax rate of return with the Committee's recommended return.

Q. ARE YOU RECOMMENDING ANY REVISIONS TO THE COMPANY'S PROPOSED ADJUSTMENT FOR CHARGES FROM QUESTAR INFOCOMM BEYOND CHANGING THE PRETAX RETURN AMOUNT?

A. Yes. I have numerous concerns with the charges to QGC from Questar InfoComm (QIC). I made several revisions to the Company's adjustment for charges from QIC and additional adjustments are likely appropriate.

Q. WHAT LEVEL OF COSTS WERE ALLOCATED TO QGC FOR SERVICES PROVIDED BY QIC, AND HOW DOES THAT COMPARE TO THE LEVEL OF

COSTS ALLOCATED FROM QIC IN THE COMPANY'S LAST RATE CASE?

- A. According to Corrected Exhibit QGC 4.4, page 13D (provided in response to CCS 10.7) total QIC charges to QGC, both direct and allocated through other affiliates, totaled \$18,451,568 in 2001. This would not include charges from QIC that were capitalized on QGC's books, only those that were expensed. In the last rate case proceeding (Docket No. 99-057-20), the Company indicated that the Questar InfoComm billings to Questar Gas Company were \$13,158,284.³ This is a significant increase in charges to QGC from QIC. In fact, the Company's Corrected Exhibit QGC 4.4, page 13D indicates that 51.66% of QIC's revenues are GENERATED from QGC, either directly or allocated via other affiliates. On Corrected Exhibit QGC 4.4, page 13D, the Company removes \$2,299,104 of QIC charges to QGC.

Q. HOW DID THE COMPANY CALCULATE ITS ADJUSTMENT FOR CHARGES FROM QIC?

- A. The Company first determined the total operating assets for QIC of \$17,855,642. It then applied the pre-tax cost of capital to determine an "allowed return" for QIC of \$2,337,070. Second, the Company subtracted QIC's total operating expenses from its revenues in order to determine QIC's operating income for 2001 of \$6,787,786. Third, QGC subtracted the "allowed return" of \$2,337,070 from the operating income of \$6,787,786 to determine the gross adjustment to QIC revenues. Since 51.66% of QIC's 2001 revenues came from QGC, it applied the 51.66% factor to the gross adjustment, resulting in the \$2,299,104 proposed reduction to charges from QIC (which totaled \$18,451,568 during 2001).

Q. DID YOU REVIEW THE 2001 INVOICES TO QGC FROM QIC?

- A. Yes. I reviewed these bills during an on-site review at Questar's offices and

³Company response to CCS 2.107, Workpaper 14C in Dkt. 99-057-20.

received copies of several of the invoices. When questioned regarding how the hourly rates and the usage rates on the invoices were determined, the Company indicated that QIC's charges were comparable to market-based rates. However, it had no support for this contention. During the on-site review I was told that an employee at QIC keeps track of what market based rates for the services are, but not employees at QGC and QRS. In CCS 10.12, the Company was asked if this understanding, based on the conversation, was correct. The Company responded as follows:

It is our understanding that QIC personnel periodically surveyed other IT and telecommunications service providers to ensure that their rates for 2001 were at or below the current rate in the marketplace. However, many of the services provided by QIC are for maintenance to legacy business systems that are complex, specifically tailored, and unique and have no marketplace counterparts. Where comparative data is available, QGC and QRS periodically check QIC rates with rates charged by others. QGC and QRS reviews have shown that QIC's rates are at or below the market rates.

In CCS 10.11, the Company was asked to explain any and all steps QRS and QGC have taken to determine whether or not the charges from QIC are market based and/or competitive. The Company's response to this question was:

Many services performed by QIC are on unique QGC legacy systems for which market comparatives would not be available. Hence, QGC and QRS did not conduct formal market surveys of IT and telecommunications rates. However, adjustments have been made to include expenses at QGC's allowed cost of service level.

Since the Company's adjustment is based on an allowed cost of service for QIC based on QIC's assets, the Company's position appears to be that the actual amounts charged from QIC are effectively irrelevant.

Q. HAVE THERE BEEN ANY CHANGES SINCE THE END OF THE 2001 TEST YEAR IN THE METHOD BY WHICH QIC BILLS QGC FOR SERVICES?

A. Yes. In 2002, QIC began billing QGC and QRS under service level agreements,

rather than on actual hours and rates. As of July 2002, however, no formal agreement or contract had been entered between QGC and QIC for this new billing arrangement. The amount included in the Company's filing for charges from QIC are not based on the actual bills from QIC, but rather its proposed "allowed return."

Q. DID QGC OR QRS RECEIVE COMPETITIVE BIDS FOR THE SERVICES IT RECEIVES FROM QIC?

1. No, it did not. Not receiving competitive bids for significant levels of services is a major concern. This concern is amplified when the services are provided by an unregulated affiliate. In its response to CCS 10.10, the Company stated that competitive bids for many of the services provided by QIC are not possible because of the customization of the legacy information system and QGC's and QRS's needs for priority on their communication systems. The Company also confirmed in the response that it did not obtain competitive bids for services currently provided by QIC.

Q. YOU INDICATE THAT THE COMPANY'S FILING INCLUDES CHARGES FROM QIC BASED ON AN "ALLOWED RETURN" METHOD. DO ANY ADJUSTMENTS NEED TO BE MADE TO THE QIC OPERATING ASSETS TO WHICH THE "ALLOWED RETURN" IS BEING APPLIED?

- A. Yes. The Company provided an itemization of the components included in the \$17,855,642 of QIC operating assets. In addition to the inventories, plant in service and accumulated depreciation on the plant, the Company included other assets, such as cash, accounts receivable, accounts receivable from affiliates and prepaid expenses. I recommend that the amounts included for accounts receivable, intercompany accounts receivable, prepaid expenses and cash be removed. As shown on CCS Exhibit 3.3.8, page 4 of 5, this would reduce the QIC operating assets to which the return is applied from \$17,855,642 to \$12,438,266.

Q. WHY SHOULD THOSE ITEMS BE REMOVED IN DETERMINING THE QIC

OPERATING ASSETS TO WHICH THE RETURN IS APPLIED?

- A. Inclusion of these items is similar to including a cash working capital requirement for QIC for recovery. However, other significant balance sheet items, which would offset these current assets, are excluded. For example, QIC had \$2.5 million of accounts payable on its books at December 31, 2001. Additionally, there was \$708,615 of intercompany accounts payable and \$18.8 million of current intercompany notes payable on its books as of that same date. The Company has included the accounts receivable in its calculation, but has not included its accounts payable as an offset.

Q. DO YOU HAVE ANY ADDITIONAL CONCERNS WITH THE METHOD USED BY THE COMPANY IN DETERMINING THE ADJUSTED TEST YEAR EXPENSES APPLICABLE TO CHARGES FROM QIC?

- A. Yes. By applying a pre-tax return to QIC's assets based on QGC's return on equity, the Company has essentially performed a revenue requirement type calculation for QIC. QIC is a non-regulated affiliate, not a regulated entity. Considering the performance of numerous information technology firms during the past several years, the allowance of QGC's approved return on equity on QIC's operating assets may seem generous in comparison.

Q. WHAT IS YOUR RECOMMENDED REDUCTION TO QIC COSTS DIRECTLY CHARGED AND ALLOCATED TO QIC?

- A. As shown on CCS Exhibit 3.3.8, page 4, I recommend that the 2001 test year charges from QIC be reduced by \$2,785,710. The Company's Corrected Exhibit QGC 4.4, page 13D indicates that \$2,299,104 should be removed, which is \$486,606 less than my recommended adjustment. However, the adjustments only pertain to the charges from QIC that were booked to expense by QGC. It does not adjust the amounts directly charged from QIC that were capitalized on QGC's books. The Commission may wish to consider additional adjustments to reduce the amount of plant in service (along with related accumulated depreciation and

depreciation expense) on QGC's books for costs charged from QIC that were capitalized.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.